In the Supreme Court of the United States

OCTOBER TERM, 1939

NO. 682

J. STEVE ANDERSON,
Petitioner,
VERSUS
GUY T. HELVERING,
Respondent.

NO. 683

L. H. PRICHARD,
Petitioner,
VERSUS
GUY T. HELVERING,
Respondent.

PETITION FOR WRITS OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

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INDEX

Page

Petition for Writs of Certiorari 1

I. Summary Statement of Matter Involved 1
Thomas v. Perkins, 301 U. S. 655 14

II. Reasons Relied on for the Allowance for the Writs 18

Bettendorf v. Com'r (1931), 49 Fed. (2d) 173 19

Central L. Assur. Soc. Mut. v. Com'r (1931), 51 Fed. (2d) 939 19

Com'r v. Elliott Pet. Co. (1936), 82 Fed. (2d) 198 18

Com'r v. Fleming (1936), 82 Fed. (2d) 324 18

Com'r v. Williams (1936), 82 Fed. (2d) 328 18

Dearing v. Com'r (1939), 201 Fed. (2d) 91 18

Helvering v. Falk, 291 U. S. 183 20

Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312 19

Holly Develop. Co. v. Com'r (1937), 93 Fed. (2d) 146 18

Mark D. Eagleton (1937), 35 B. T. A. 551 20

Ortiz Oil Corp. v. Com'r (1939), 102 Fed. (2d) 508 18

Palmer v. Bender, 287 U. S. 551 18

Perkins v. Thomas (1936), 86 Fed. (2d) 954 18

Shellabarger v. Com'r (1930), 38 Fed. (2d) 566 19

Page

Spalding v. United States (1938), 97 Fed. (2d) 697 18

Stephen J. Hallahan (1928), 14 B. T. A. 584 20

Thomas v. Perkins, 301 U. S. 655 19

112 West 59th St. Corp. v. Helvering (1933), 68 Fed. (2d) 397 19

Brief in Support of Petition for Writs of Certiorari . . 21

I. The Opinion of the Board of Tax Appeals and the Court Below 21

II. Jurisdiction. 22

Helvering v. Winmill, 305 U. S. 79 22

U. S. Trust Co. v. Helvering, 307 U. S. 57 22

III. Statement of the Case 23

IV. Assignment of Errors 23

Thomas v. Perkins, 301 U. S. 655 24

V. Argument 25

Synopsis of Argument 25

First Proposition: Under the contract of sale between the Oklahoma Company and Prichard that company retained an economic or equitable interest in the property sold and transferred to the extent in value of $110,000 and interest to accrue thereon, notwithstanding the complete legal title to such property was assigned and conveyed to and became vested in Prichard, and notwithstanding that the contract recited that the company re-

Page

tained a lien on one-half of all oil and gas production and fee interest out of the proceeds from which said sum was to be made and paid without personal obligation of Prichard other than to operate and/or sell and account, and therefore, the one-half of such gross proceeds realized from oil produced from the property and payable and paid to the company under the contract was income to it direct from the property and was never income to Prichard 27

Alexander v. Continental Pet. Co. (10th C. C. A., 1933), 63 Fed. (2d) 927 37

Com'r v. Elliott Pet. Co. (9th C. C. A., 1936), 82 Fed. (2d) 193 32

Com'r v. Fleming (5th C. C. A., 1936), 82 Fed. (2d) 324 30

Com'r v. Williams (5th C. C. A., 1936), 82 Fed. (2d) 328 32

Dearing v. Com'r (5th C. C. A., 1939), 102 Fed. (2d) 91 32

Helvering v. Bankline Oil Co. (1938), 303 U. S. 362 40

Helvering v. Elbe Oil Land Develop. Co. (1938), 303 U. S. 372 40

Helvering v. O'Donnell (1938), 303 U. S. 370 40

Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312 . . . . . 30, 38

Holley Develop. Co. v. Com'r (9th C. C. A., 1937), 93 Fed. (2d) 146 . . . . . 32, 33

Ortiz Oil Co., 37 B. T. A. 656 34

Ortiz Oil Corp. v. Com'r (5th C. C. A., 1939), 102 Fed. (2d) 91 32

Page

Palmer v. Bender, 287 U. S. 551 30

Perkins v. Thomas (5th C. C. A., 1936), 86 Fed. (2d) 954 32

Spalding v. United States (9th C. C. A., 1938), 97 Fed. (2d) 697 (Cert. den., 305 U. S. 571) 32

Thomas v. Perkins, 301 U. S. 655 .....28, 38

Wilbert Mineral Corp., 38 B. T. A. 355..... 36

Second Proposition: Under the terms of the contract between the Oklahoma Company and Prichard he took the legal title to the properties involved by transfer and conveyance from the company as its trustee or agent or attorney in fact and repository of title for the purpose of operating and/or selling such properties and paying over to it one-half of the gross proceeds so realized therefrom up to $110,000 and hence all sums so paid to it were income direct to it from the properties and were never income to Prichard 44

Bettendorf v. Com'r of Internal Rev. (8th C. C. A., 1931), 49 Fed. (2d) 173 46

Central L. Assur. Soc. Mut. v. Com'r of Internal Revenue (8th C. C. A., 1931), 51 Fed. (2d) 939 48

Helvering v. Falk (1934), 291 U. S. 183,... 49

Mark D. Eagleton, 35 B. T. A. 551, 562 50

Shellabarger v. Com'r (7th C. C. A., 1930), 38 Fed. (2d) 566 45

Stephen J. Hallahan, 14 B. T. A. 584, 596, 597 50

Conclusion 53

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L. H. PRICHARD,
Petitioner,
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GUY T. HELVERING,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

TO THE HONORABLE SUPREME COURT OF THE UNITED STATES

Your petitioners respectfully show:

I.

SUMMARY STATEMENT OF MATTER INVOLVED

These cases involve income taxes for the year 1932. They present precisely the same questions of law upon the same state of facts. They arose in the United States Board of Tax Appeals and because of their substantial identity on the facts and law, they were consolidated with

each other and with a similar case brought by R. Olsen and were decided by the Board in one memorandum opinion which is not reported. Each of the petitioners before the Board filed a petition for review with the United States Circuit Court of Appeals for the Tenth Circuit. There the three cases were consolidated by agreement of the parties and order of the court, because on the only questions there presented for review they were identical. Olsen does not bring his case here because of the very small amount of tax involved in it, and this petition is presented on behalf of Anderson and Prichard only. Their cases are separately docketed but are regarded as consolidated for the purpose of this petition and the required copies of the consolidated printed record in the court below with the additional printing necessary are filed in this Court.

The issues and facts as disclosed by the pleadings and the findings of fact by the Board of Tax Appeals may be summarized as follows:

For some time prior to March 19, 1931, Prichard, a business associate of Anderson and Olsen, and acting as agent and trustee for himself and them, carried on negotiations with the Oklahoma City Company, a corporation, of Oklahoma City, Oklahoma, hereinafter referred to as the Oklahoma Company, and of which one L. E. Patterson was owner, for the purchase of a number of items of property consisting of real estate in fee, royalty interests or mineral rights in real estate, interests in the working interest or leasehold interest in oil and gas leases, and rights to receive various sums of money to be paid out

of oil and gas to be produced from oil and gas properties, being commonly known as in-oil payments. All of these parcels and kinds of property were situated in Oklahoma City, in the County and State of Oklahoma, and were generally classed as oil properties, for that they either had or were believed to have oil value. Olsen and Anderson were to and did assist Prichard in carrying on the negotiations, and it was agreed among them by an express contract that whatever properties were acquired in his name through such negotiations would belong to the three of them in the proportions of 10% to Olsen, 45% to Prichard, and 45% to Anderson (R. 26-27). As a result of the negotiations the Oklahoma Company agreed to sell, convey and assign to Prichard all the property in question for the consideration of $50,000 to be paid in cash, and $110,000 with interest to be paid out of one-half of the proceeds derived from all oil and/or gas produced, saved and sold from the property, or from the sale of any part of the property itself (R. 17-24).

Thereupon Prichard opened negotiations with the Oil Brokerage and Investment Company, a corporation of Wichita, Kansas, the name of which was later changed to Winkler-Koch Royalty Company and is sometimes referred to in the record in these cases by that name, but which will be hereinafter referred to as the Investment Company, for the purchase by that company of an interest in the properties offered by the Oklahoma Company. These negotiations resulted in an agreement between Prichard and the Investment Company that it would pay

the $50,000 down payment in cash required to be paid to the Oklahoma Company, and in consideration thereof, would receive an assignment and conveyance of a half-interest in the properties and as owners would receive half of any and all revenues of whatever kind realized from the properties until it had so received the sum of $50,000 and thereafter would receive one-fourth of such revenues until the sum of $110,000 and interest, required to be paid to the Oklahoma Company in accordance with its proposal out of one-half of the gross receipts from the properties, should be fully paid from that source, and thereafter as owner again receive one-half of all such revenues (R. 24-25).

On his part Prichard agreed to consummate the purchase of the properties from the Oklahoma Company on terms offered and to take title thereto in his name and then to assign and convey to the Investment Company the interest therein that it would be entitled to receive under the agreement with it, and further agreed personally to stand one-half of any loss that it might sustain in event it did not receive back the full $50,000 paid in cash out of the revenues from the property payable to it.

Pursuant to this agreement with the Investment Company, Prichard, under date of March 19, 1931, entered into a written contract and agreement with the Oklahoma Company for the purchase of the properties on the terms previously proposed. Then, under date of March 23, 1931, he made written assignment and conveyance to the Investment Company of the interest in these which it was

to acquire under his previous agreement with it (R. 24-25), and also made written assignment to Olsen and Anderson of their interests therein (R. 26-27).

The $50,000 down payment in cash was made to the Oklahoma Company and it executed and delivered to Prichard valid instruments conveying to him the various rights and interests in property and the parcels of property, specified in the contract, together with abstracts of title to the real estate involved and contracts and title papers for the leasehold interests and in-oil payments, all of which were absolute conveyances of title without any exception or reservation or the retention of any interest or lien therein, and thereupon Prichard took possession of all thereof and held the title thereto in trust for himself and Olsen, Anderson, the Investment Company and the Oklahoma Company, according to his and their respective interests therein.

The provision for the deferred payment of $110,000 and interest is the nub of the controversy in these cases. It is found in the third paragraph of the contract between Prichard and the Oklahoma Company and the material part of it is as follows:

> "As a further consideration the party of the first part is to have and receive one-half of the proceeds received by L. H. Prichard which may be derived from all oil and/or gas produced, saved, and sold from said above described properties, and shall have and receive one-half of the proceeds derived from the sale of fee title to any or all of the lots conveyed herein, until said party of the first part has received the sum of $110,000.00 in addition to the $50,000.00 hereinabove

mentioned. Said $110,000.00 to draw interest at the rate of 6% (six per cent) per annum from the date of the signing of this agreement, said interest to be paid from the amounts accumulated from the proceeds through sales or production as above mentioned, at which time it is understood and agreed that the party of the first part shall have no further claim to the properties above described, and it is also agreed that the party of the first part shall have a first lien and claim against that one-half of all oil and gas production and fee interest as above described from which the $110,000.00 is payable as provided for herein, it being understood and agreed that said lien and claim shall not in any way affect the one-half interest in all oil and gas production and fee interest or the revenue therefrom which party of the second part is to have and receive under this agreement * * *. It being understood and agreed between the parties hereto that any sum or sums accumulating under this agreement is payable direct to the party of the second part or assigns, including such amounts that may become due and payable from pipe line companies purchasing oil and/or gas from said properties, and it is agreed that one-half (½) of such revenues due the party of the first part shall be payable at the end of each ninety days after May 25, 1931, such sums to be placed to the credit of the party of the first part, * * * as provided for herein, in the Tradesmens National Bank of Oklahoma City, Oklahoma, at which time a full, complete, accurate and itemized statement of any oil payments or other revenues shall be submitted, and said Bank is hereby fully authorized and directed by the party of the first part to deliver to the party of the second part good and sufficient receipts for such sums, and it is agreed that a copy of this agreement with a release from the party of the first part * * * shall be

placed in escrow in said Bank until the sum of $110,000 plus interest as provided for, has been paid in full, at which time said Bank is authorized and directed to deliver to the party of the second part the release attached thereto" (R. 21-22).

Prichard took and held possession of the properties and property rights covered by the contract with the Oklahoma Company, and operated the same for the remainder of 1931 and thereafter. During 1931 and 1932 he received all money representing proceeds from sales and from oil and gas produced from the properties, and distributed it in accordance with the above contract In 1931 the gross proceeds were $55,833.17. He paid that in equal amounts to the Oklahoma Company and the Investment Company. In 1932 the gross proceeds were $81,547.15. He distributed one-half of that to the Oklahoma Company and $23,695.91 of the other one-half to the Investment Company which paid in full the $50,000 due it. Then he distributed one-half of the remainder to the Investment Company and the other half of the remainder to himself, Anderson and Olsen, in the proportions of 45, 45 and 10 (R. 15). Both Prichard and Anderson kept books and made their returns upon an accrual basis (R. 14). Prichard reported income for 1932 from the properties in question of $3,165.19 and Anderson reported the same amount. On their reported oil income from the properties they took appropriate depletion deduction. No part of the sum paid the Oklahoma Company was included in the income of either of them (R. 15).

The Commissioner in his notice of deficiency to Anderson makes the following adjustment to the income which the taxpayer reported on his return:

"Add: 1. Income from joint venture $11,612.88" (R. 11).

And in explanation of this adjustment it is said:

"1. In-oil payments received in connection with the Patterson Deal and oil properties of the Prichard-Olsen Joint Venture not reported have been included as taxable income in accordance with the decision rendered in the Comar Oil Company case, 24 United States Board of Tax Appeals, 688, affirmed in the Circuit Court of Appeals, 64 Fed. (2d) 965" (R. 12).

The "Patterson Deal" referred to is the Oklahoma Company Deal. It is so referred to because Patterson owned that company (Board's Findings of Fact, R. 15).

In the notice of deficiency in the Prichard case appears the following adjustment to income reported on the taxpayer's return:

"Add: 1. Increase in royalty income $12,684.78" (R. 50).

The explanation of this addition to income is in the identical language above quoted from the Anderson case (R. 49). [In printing the record, parts of the statement in the Prichard notice of deficiency have become transposed. That part appearing on page 50 beginning with the word "Statement" and ending with "Net income subject to Normal tax $25,177.36" should appear on page 49 preceding the line "Normal tax at 4% on $4,000 $160."]

The Prichard-Olsen Joint Venture referred to in the quoted explanation from the notices of deficiency was a transaction wholly unrelated to the Oklahoma Company or Patterson deal and the tax liability of the petitioners arising out of that transaction was stipulated before the Board (Board Findings of Fact and Opinion, R. 14) and was not involved in the Board's decision and is not involved here.

It will be noted that Prichard was not personally obligated by the contract with the Oklahoma Company for the payment of any part of the $110,000. This was payable only if, as and when realized from the properties conveyed to him.

It will also be noted that the only income from the properties here in dispute is from oil production, that is, the in-oil payments specified in the Commissioner's notices of deficiency as made in connection with the Patterson (Oklahoma Company) deal. Whether proceeds from the sales of fees paid to Oklahoma Company, if any, were or were not taxable income to Prichard is not presented on this record.

Petitioners' contention in regard to all payments made on the $110,000, whether from proceeds of oil production or from the sale of fees, is stated in Anderson's petition before the Board as follows:

> "The petitioner says that the right to receive this $110,000 represented a retained interest by the Company in the property conveyed and assigned and was in substance and in fact a reserved or excepted in-

terest in the conveyance and assignment thereof to the extent of $110,000. The interest in the property which that $110,000 represented never passed or belonged to or became the property of L. H. Prichard and those whom he represented. None of said sum as derived from said property was his or their income, but at all times was the property and money and income of and belonged to the Oklahoma City Company, and L. H. Prichard, in collecting and receiving it into his hands and paying it over to the Oklahoma City Company, acted as the mere agency or channel through which the Company's retained interest in the property was converted into money and transmitted to it" (R. 7).

The same contention in effect is made with respect to the payments to be made from revenues derived from the properties to the Investment Company (R. 7).

Precisely the same contentions are made in Prichard's petition before the Board (R. 45-46).

The Board found the facts substantially as above set forth (R. 14-16). That part of its opinion touching on the present question is in full as follows:

"The petitioners requested sixty days after the hearing within which to file a brief. The hearing was held on October 19, 1937. No brief has been filed to date. It may be that the petitioners have become convinced that there is no merit to their contentions. But in any event, we have but a poor idea of what they contend. The Commissioner treated all receipts less depletion as income, and regarded the disbursements to Oklahoma City Company, and perhaps part of those to Oil Brokerage, as payments of the purchase price of $160,000. We can find no error in this action of the Commissioner. Cf. *Comar Oil Co.*, 24

B. T. A. 688, aff'd 64 Fed. (2d) 965. This case is distinguishable in several important respects from *Thomas* v. *Perkins*, 301 U. S. 655, in which the Comar case is mentioned as 'In apparent conflict.' Payment of the purchase price here was in cash paid by Prichard. Sales of fees were involved. The seller retained a lien. How much of the gross receipts was from sales of fees, how much from oil and gas produced from fees, and how much from royalties on leases is not shown. The record does not justify any change in the Commissioner's determination relating to these items" (R. 16).

It will be noted that the Board says that:

"Payment of the purchase price here was in cash paid by Prichard."

This statement is obviously incorrect and untrue, if it is understood to mean that the entire purchase price of $160,000 was a cash payment which Prichard was personally obligated to pay and did pay in cash with his own money. So construed it ignores the fact that $110,000 of said "purchase price" was not payable out of any funds that belonged to Prichard, but only out of one-half of the proceeds "which may be derived from all oil and/or gas produced, saved and sold from said above described properties," and "one-half of the proceeds derived from the sale of fee title to any or all of the lots conveyed herein" (R. 21).

The Board's statement is understandable only on the assumption that all proceeds from the property payable to Oklahoma Company as provided was first income to Prich-

ard. But this is an assumption of the very point in controversy as an argument to support the Board's conclusion on that point. Indeed, the record shows that only one-half of $55,833.17 in 1931 and only one-half of $81,547.15 in 1932 had been realized and paid over to the Oklahoma Company out of its reserved share in the proceeds from the property. By computation it appears that at the end of 1932 the Oklahoma Company had received only $68,690.16 of the total of $110,000 and interest which it had the contract right to receive. Whether the remainder of approximately $50,000 and interest ever would be realized and received by it out of its contract right to receive one-half of the gross proceeds from the property does not appear from this record. Certainly Prichard was under no obligation to pay any deficiency in the $110,000 and interest in cash or otherwise, and unless paid from the property, it never would be paid.

It will also be noted that the Board says that:

"Sales of fees were involved."

If this is understood as meaning that sales of fees were involved in the contract with the Oklahoma Company, it is a correct statement, but if it is considered as meaning that proceeds of sales of fees were included in the additions to income here in dispute, then it is an incorrect and untrue statement, and is without support in the Board's findings of fact or otherwise in the record, for, as previously pointed out, the Commissioner's notices of deficiency, which are the very basis of the Board's juris-

diction, specifically limit the additions to the income of each taxpayer, insofar as here in controversy, to the in-oil payments to the Oklahoma Company (R. 11-12, 49-50, and page 8 *supra*).

It is repeated for emphasis that this case now deals only with the in-oil payments to the Oklahoma Company out of one-half of the proceeds from the sale of oil produced from the properties involved.

It will also be noted that the Board says that:

> "The petitioners requested sixty days after the hearing within which to file a brief. The hearing was held on October 19, 1937. No brief has been filed to date. It may be that the petitioners have become convinced that there is no merit to their contentions. But in any event, we have but a poor idea of what they contend" (R. 16).

There is no rule of the Board that requires the filing of a brief and permission to file one is a privilege. It is true that petitioners' counsel, after taking time to file a brief, had not done so at the time of the Board's opinion. The Board's quoted language indicates resentment and pique because such brief was not filed. Whether this influenced its decision petitioners do not undertake to say, and the point is not material here, for it is the decision of the Appeals Court, and not the Board's opinion, that is now under consideration.

In passing it may be said that the member who wrote the Board's opinion was not the member who tried the case, and that it was fully understood at the trial by the

member presiding and by the parties that petitioners relied on the case of *Thomas* v. *Perkins*, 301 U. S. 655, and similar decisions in various circuit courts of appeals, to support their claimed exclusion from Prichard's income of the in-oil payments to the Oklahoma Company. Indeed, the Commissioner's representative at the trial conceded that those cases would control and those in-oil payments were not properly included in Prichard's income, and it was only because of other disputed questions, reliance on which petitioners did in fact thereafter abandon, that a trial was necessary. Certainly an examination of the petitions in the case (R. 7, 45) would have given the Board a very clear idea of what the taxpayers contended in regard to those in-oil payments.

After the Board's decision and because of the above quoted stricture, counsel for petitioners filed with it a motion to vacate its findings of fact and opinion and to reconsider and redecide the case. This appears in full at pages 28 to 32 of the record and need not be reproduced here. It expresses petitioner's answer to the Board's criticism of omission to file a brief and was calculated to give it a clear idea, instead of its poor idea, of what they contended in respect of the in-oil payments, which is the only part of the Board's or of the court's decision of which the petitioners here complain. The Court may read that motion in the record if it is deemed of any importance (R. 28-32).

In its decision the Appeals Court agrees that only the

in-oil payments from proceeds of oil and gas produced from the properties were in controversy and it deals only with such in-oil payments. It says:

> "During the years 1931 and 1932 Prichard received all the proceeds from sales of oil and gas produced from the properties" (R. 81).

Then it gives the total figures of such gross proceeds for each year and the manner of the distribution thereof. It does not consider any other revenues or proceeds of any sort derived from the property than those from the sales of oil and gas (R. 81).

But that Court makes a slightly erroneous statement of petitioners' contention in the case as follows:

> "Petitioners contend that the Oklahoma Company reserved a legal or equitable interest in one-half of the lands and interests transferred to Prichard to the extent of $110,000 with interest; and that the payments made to the Oklahoma Company were not income to petitioner" (R. 81).

The petitioners never did contend that the Oklahoma Company retained any "legal" interest in the properties, for the instruments of transfer of those properties were absolute and unqualified assignments and conveyances. There was no reservation of any sort of interest, much less any legal interest, specified in those assignments and conveyances. The petitioners' contention was and is that Oklahoma Company by its stipulated right in its contract for the sale and transfer of the properties to receive $110,000 out of a portion of the proceeds and revenues realized

therefrom and not otherwise, reserved and retained an economic interest or an equitable interest in such properties entirely consistent with the passing of the absolute legal title thereto to Prichard and entirely consistent with the informal retention of a lien on one-half of all oil and gas production and fee interest as well to secure the performance of the agreement by Prichard and the payment by him of its reserved share of the stipulated gross proceeds (R. 22).

It is not necessary, and would not be helpful, to reproduce the decision of the Appeals Court here. An examination of it shows that the Board's decision is affirmed on the sole ground that because the properties were transferred to Prichard by absolute assignments and conveyances, and a lien stipulated in the contract to secure the payment to the Oklahoma Company of a reserved portion of the proceeds derived from such properties, the instant case was distinguishable from *Thomas* v. *Perkins*, 301 U. S. 655, and that, in reaching this conclusion, the Appeals Court ignored all the authorities, including decisions of this Court, holding that where one had a right to receive the payment of a certain sum or percentage out of oil production from a property and not otherwise, the legal ownership of such property was wholly immaterial, because such an one had an economic interest in the oil reserve or deposit by reason of which the in-oil payments received by him were income direct from the property to him and were not income to the holder of the legal title to the property.

The precise question which the Appeals Court decided adversely to petitioners and which is presented to this Court for consideration, is whether the Oklahoma Company, by virtue of its contract right to receive one-half of the gross proceeds from oil and gas produced from the property which it transferred to Prichard until it should have received $110,000, had such an economic interest or equitable interest in that property, notwithstanding Prichard held the legal title thereto, that those in-oil payments were its income direct from the property, or were Prichard's income from the property, and represented deferred cash payments made by him with money which belonged to him.

Then there is the further question, which was urged before the Appeals Court but not considered in its decision, and is again urged here, of whether in any event by the terms of the contract under which Prichard took title to the property involved by absolute assignments and conveyances, he held such title as trustee or agent for the Oklahoma Company to the extent of its right to receive $110,000 out of revenues realized therefrom, with power to operate and/or sell the properties and collect, receive and pay over one-half of all gross proceeds realized in any manner to that company until it received $110,000.

No question is raised here on the Appeals Court's decision in respect of the transaction between Prichard and the Investment Company.

II.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRITS

1. The Circuit Court of Appeals below, in holding that the Oklahoma Company did not have an economic interest in the oil deposit or reserve in the property which it conveyed to Prichard to the extent of the sum specified by contract as payable to it out of oil production from that property and, therefore, that amounts paid to it by him out of proceeds from such oil production were his income and not its income from the property, has rendered a decision in conflict with the decisions of the Circuit Court of Appeals of the Ninth Circuit in *Commissioner* v. *Elliott Petroleum Co.* (1936), 82 F. (2d) 193, and in *Holly Development Company* v. *Commissioner* (1937), 93 F. (2d) 146, and in *Spalding* v. *United States* (1938), 97 F. (2d) 697, and in conflict with the decisions of the Fifth Circuit Court of Appeals in *Commissioner* v. *Fleming* (1936), 82 F. (2d) 324, and in *Commissioner* v. *Williams* (1936), 82 F. (2d) 328, and in *Perkins* v. *Thomas* (1936), 86 F. (2d) 954, and in *Dearing* v. *Commissioner* (1939), 102 F. (2d) 91, and in *Ortiz Oil Corporation* v. *Commissioner* (1939), 102 F. (2d) 508, on the same matter.

2. The Circuit Court of Appeals below in its holding set forth in the preceding paragraph has decided a federal question, namely, the interpretation and application of the provisions of the Revenue Act of 1932 to the facts of the case, in a way in conflict with the applicable decisions of this Court in *Palmer* v. *Bender*, 287 U. S. 551.

Helvering v. *Twin Bell Oil Syndicate*, 293 U. S. 312, and *Thomas* v. *Perkins*, 301 U. S. 655.

3. The Circuit Court of Appeals below in holding that the one-half of all gross proceeds realized by Prichard in any manner from the property conveyed to him by the Oklahoma Company reserved and made payable to it by contract until it had received the sum of $110,000, and for the payment of which Prichard was not personally or otherwise liable, was his income, and in refusing to hold that he was merely a conduit or agency or trustee for receiving such one-half of the gross proceeds so realized and paying the same over to Oklahoma Company until the payments amounted to $110,000, has rendered a decision in conflict with the decision of the Circuit Court of Appeals of the Seventh Circuit in *Shellabarger* v. *Commissioner* (1930), 38 F. (2d) 566, and with the decisions of the Circuit Court of Appeals of the Eighth Circuit in *Bettendorf* v. *Commissioner* (1931), 49 F. (2d) 173, and *Central Life Assurance Society Mutual* v. *Commissioner* (1931), 51 F. (2d) 939, and with the decision of the Court of Appeals of the District of Columbia in *112 West 59th Street Corporation* v. *Helvering* (1933), 68 F. (2d) 397, on the same matter.

4. The Circuit Court of Appeals below, in its holding set forth in the preceding paragraph, has decided an important question of general law in a way probably untenable and in conflict with the weight of authority, for that its decision is in conflict with the cases cited in the preceding paragraph and with numerous decisions of the

United States Board of Tax Appeals, among which are *Stephen J. Hallahan* (1928), 14 B. T. A. 584, and *Mark D. Eagleton* (1937), 35 B. T. A. 551, and with the applicable decision of this Court in *Helvering v. Falk*, 291 U. S. 183.

Wherefore, your petitioners pray that writs of certiorari issue under the seal of this Court directed to the United States Circuit Court of Appeals for the Tenth Circuit at Denver, Colorado, commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings of said Court had in case No. 1870 entitled *J. Steve Anderson, petitioner*, v. *Commissioner of Internal Revenue, respondent*, and in case No. 1871 entitled *L. H. Prichard, petitioner*, v. *Commissioner of Internal Revenue, respondent*, to the end that said causes and each of them may be reviewed and determined by this Court as provided by the Statutes of the United States and that the judgments of said United States Circuit Court of Appeals in each of said causes be reversed by this Court, and for such further relief as to this Court may seem proper.

Dated at Oklahoma City, Oklahoma, this 25th day of January, 1940.

J. STEVE ANDERSON,
L. H. PRICHARD,
Petitioners,

By CHAS. H. GARNETT,
608 Hales Building,
Oklahoma City, Oklahoma,
Counsel for Petitioners.

In the Supreme Court of the United States

OCTOBER TERM, 1939

NO. . . . . . .

J. STEVE ANDERSON,
Petitioner,
VERSUS
GUY T. HELVERING,
Respondent.

NO. . . . . . :

L. H. PRICHARD,
Petitioner,
VERSUS
GUY T. HELVERING,
Respondent.

PETITION IN SUPPORT FOR WRITS OF CERTIORARI

I.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

The opinion of the Board of Tax Appeals in these cases is a memorandum opinion and is not officially reported. It appears at pages 14 to 17 of the record.

The opinion of the Circuit Court of Appeals below is reported in 107 Fed. (2d) 459 and appears at pages 79 to 84 of the record.

II.
JURISDICTION

1. The date of the judgment to be reviewed is November 1, 1939 (R. 84). The opinion of the court was handed down on the same date (R. 79).

2. The statutory provision under which the jurisdiction of this Court is invoked and which is believed to sustain its jurisdiction, is Section 347(a) of Title 28 of the United States Code, being Section 240 of the Judicial Code, as amended.

3. The decision of the court below is in conflict with the decisions of the various Circuit Courts of Appeals and of this Court as set forth in the statement of the grounds relied on for issuance of the writs in the petition filed herein. This Court entertains jurisdiction to grant writs of certiorari in similar cases at every term, and among the great number of such similar cases in which the writ has been granted are the following, which are believed to sustain this court's jurisdiction here:

Helvering v. *Winmill*, 305 U. S. 79.

United States Trust Co. v. *Helvering*, 307 U. S. 57.

4. The petition for the writs is presented under Rule 38, paragraph 5(b), of the revised rules of this Court as amended to June 4, 1934.

III.
STATEMENT OF THE CASE

A concise statement of the case containing all that is material to the consideration of the questions presented, with appropriate page references to the printed record, has been made in the petition for the writs herein and such statement is hereby adopted and made a part of this brief.

IV.
ASSIGNMENT OF ERRORS

The petitioners make the following assignment of errors committed in the opinion and decision of the court below:

1. The Circuit Court of Appeals erred in holding that the one-half of the gross proceeds of oil and gas produced in 1932 from property sold and conveyed to L. H. Prichard in 1931 by the Oklahoma Company, which was payable and was paid to that company under the provisions of the contract for the sale of said property which gave it the right to receive one-half of such gross proceeds until it had received $110,000, but without any personal obligation on Prichard's part to pay said sum or any part of it, was includable in his gross income.

2. The Circuit Court of Appeals erred in holding that because the Oklahoma Company transferred the absolute and unqualified legal title to the properties involved to Prichard, without reserving or excepting to itself any re-

tained interest in such legal title, its contract right to receive a part of the gross proceeds of oil produced from such properties did not constitute an economic interest or any such retained interest therein as would make the amounts so received its income direct from the properties.

3. The Circuit Court of Appeals erred in holding that because the contract for the sale and conveyance of the properties involved recited that the Oklahoma Company should hold a lien on one-half of the gross proceeds from the sale of oil produced therefrom and from the sales of fee titles as well, such lien was inconsistent with and defeated any claim of that company to an equitable or economic interest in the property or the gross proceeds derived from it.

4. The Circuit Court of Appeals erred in not holding that the disputed one-half of the gross proceeds of oil and gas produced from the involved properties was income direct from those properties to the Oklahoma Company and was not income to Prichard.

5. The Circuit Court of Appeals erred in holding that the instant case was distinguishable on the facts from the case of *Thomas* v. *Perkins*, 301 U. S. 655, and was not controlled and governed by that case.

6. The Circuit Court of Appeals erred in not holding that Prichard was a mere trustee or agent or attorney in fact and repository of title for the Oklahoma Company in taking the legal title to and possession of the property transferred and operating and or selling the same and pay-

ing over one-half of the gross proceeds to that company, and hence that the amounts so paid by him were income to it realized direct from the properties through his agency and that no part of these was income to him.

7. The Circuit Court of Appeals erred in not holding that no part of the one-half of the gross proceeds realized from the properties involved, whether from oil production or from sales of fees or both, which was payable and paid to the Oklahoma Company under the contract provision therefor, was income to Prichard.

V.
ARGUMENT

Synopsis of Argument

In support of the errors assigned the petitioners assert and rely on the following propositions which will be presented and considered in order:

I.

Under the contract of sale between the Oklahoma Company and Prichard that company retained an economic or equitable interest in the property sold and transferred to the extent in value of $110,000 and interest to accrue thereon, notwithstanding the complete legal title to such property was assigned and conveyed to and became vested in Prichard, and notwithstanding that the contract recited that the company retained a lien on one-half of all oil and gas production and fee interest out of the proceeds from which said sum was to be made and paid without personal obligation

of Prichard other than to operate and/or sell and account, and, therefore, the one-half of such gross proceeds realized from oil produced from the property and payable and paid to the company under the contract was income to it direct from the property and was never income to Prichard.

II.

Under the terms of the contract between the Oklahoma Company and Prichard he took the legal title to the properties involved by transfer and conveyance from the company as its trustee or agent or attorney in fact and repository of title for the purpose of operating and/or selling such properties and paying over to it one-half of the gross proceeds so realized therefrom up to $110,000, and hence all sums so paid to it were income direct to it from the properties and were never income to Prichard.

First Proposition

Under the contract of sale between the Oklahoma Company and Prichard that company retained an economic or equitable interest in the property sold and transferred to the extent in value of $110,000 and interest to accrue thereon, notwithstanding the complete legal title to such property was assigned and conveyed to and became vested in Prichard, and notwithstanding that the contract recited that the company retained a lien on one-half of all oil and gas production and fee interest out of the proceeds from which said sum was to be made and paid without personal obligation of Prichard other than to operate and/or sell and account, and therefore, the one-half of such gross proceeds realized from oil produced from the property and payable and paid to the company under the contract was income to it direct from the property and was never income to Prichard.

The contract of sale between the Oklahoma Company and Prichard provides that the company shall

> "Have and receive one-half of the proceeds received by L. H. Prichard which may be derived from all oil and/or gas produced and sold from said above described properties and shall have and receive one-half of the proceeds derived from the sale of fee title to any or all of the lots conveyed herein until [it has] * * * received the sum of $110,000."

and interest at 6% from the date of the contract until the above sum was paid from the specified sources (R. 21).

This was followed by a provision that the Oklahoma Company would have no interest in the property when it had received the above sum from the sources stated and that it should have a "lien and claim against that one-half of all oil and gas produced and fee interest" from which the above sum was payable.

The contract was followed by the transfer by assignments and conveyances of the full and complete legal title to all the property and property rights described in it.

There was no personal obligation or liability on the part of Prichard for the payment of the $110,000 or any part of it and no duty devolved on him in respect thereto except to account for and pay over to the Oklahoma Company one-half of the gross proceeds he might realize from the properties until the stipulated amount due it had been paid. Narrowly stated, the precise point here is whether, by reason of its contract right to be paid one-half of *the gross proceeds of oil produced from the properties* involved, the Oklahoma Company had such an equitable or economic interest in those properties as would make amounts it received out of such gross proceeds its income direct from the properties, and upon which it would be entitled to a deduction for depletion, and would exclude such amounts from Prichard's income. The Appeals Court held that because, in its transfer of the legal title to the properties, it did not except and reserve a retained interest in them, and because the contract recited that it should have a lien on one-half of the oil and gas produced and fee interest in the properties until it had been paid the specified sum, it had no equitable or economic interest in them and all income therefrom was Prichard's income and the payments to it were cash payments made out of his own funds upon deferred installments of the purchase price.

The Appeals Court distinguishes the case of *Thomas v. Perkins*, 301 U. S. 655, because under the contract involved

in that case the portion of the purchase price of the oil and gas leases transferred to be paid out of oil production, was payable direct to the sellers from the pipe line company which purchased the oil, and because it is stated in the opinion that no lien was reserved by the sellers on the property transferred. The transfer of the leases in that case was of the absolute and complete legal title with a contract provision for the payments out of oil. But the decision in *Thomas* v. *Perkins* is not made to turn on the fact that the in-oil payments were made directly by the pipe line purchaser of the oil instead of through the medium of the assignee of the lease, nor on the fact that no lien was retained, and except in those two respects the facts there are identical with the facts here.

Surely it could make no difference in the principle of law applicable that here the payment out of oil production went first to Prichard and was by him pursuant to the contract deposited in bank and at stated intervals paid over to the Oklahoma Company. The result is precisely the same as though one-half the gross proceeds from oil sales had been paid direct by the purchasing pipe line company to the Oklahoma Company. Prichard had no ownership of this one-half of the gross proceeds from the sale of oil. It could not be his money and could not be diverted and used by him for any purpose of his own. It was money in his hands that belonged and was payable to the Oklahoma Company and all that he could rightfully do was deposit it in bank and pay it over as provided in the contract. His function was merely that of a receiving and transmitting

station from the pipe line purchaser to the Oklahoma Company.

Since *Palmer* v. *Bender*, 287 U. S. 551. it has never been held by the Board of Tax Appeals, nor previously by any court that one who had the right to receive a sum of money out of oil to be produced from a certain property, and from no other source, had to have an interest in the legal title to such property before receipts from such oil production were income direct to him, and upon which he was entitled to a deduction for depletion of his interest in the oil reserve in the property.

If the owner of the oil right to such an in-oil payment was entitled to a depletion deduction on the amounts so received, and this right is no longer anywhere in dispute, then such payments could not also be income to the holder of fee title and operator of the property, for if so, he would be entitled to a deduction for depletion on such income, and deduction of double depletion may not be allowed. *Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S. 312.

In *Commissioner* v. *Fleming* (5th C. C. A.) 1936, 82 F. (2d) 324, the facts were that the owners of certain oil and gas leases:

> "Agreed with a purchaser to sell and convey by proper assignment and transfer all their entire interest in and to the above described oil and gas lease and oil, gas and other minerals produced therefrom. * * * As consideration for said property second party hereby contracts to pay first parties in the proportion of their respective interests * * * $1,000,000 in cash * * * upon the execution and delivery by said first parties of proper

legal instruments of conveyance * * * and $1,000,000 out of one-fourth of all oil, gas and other minerals produced from said working interest in said lease, being one-half of the interest hereby conveyed; said $1,000,000 is not and never shall be a personal obligation or liability against the second party, but shall be paid only out of the products if, as and when produced and sold from the said premises.'"

Thus in that case there was no reserved or retained interest in the legal title to the lease assigned and there was no provision for the payment of the in-oil payments by the pipe line company which purchased the oil, but the purchaser "*contracts* to pay * * * $1,000,000 out of a one-fourth of all oil, gas, etc."

Construing this provision of the assignment of the lease the Court said:

"The purchaser was not bound personally for these payments. If the oil ran short or proved nonexistent, the taxpayer was a proportional loser. While the contract was phrased as though the lease and all the oil were sold, and as though the proceeds were to be paid back to the seller, the real essence of the transaction was that the lease was sold and all the oil except that whose proceeds were to come to the selling taxpayer. The conveyances executed when the cash was paid might very appropriately have reserved or excepted sufficient oil from one-half of that thereafter run to pay the agreed sum. It is true that no royalty to continue indefinitely was reserved, and that the reservation was limited not to so many barrels nor to such a length of time, but to so much oil as would sell for the agreed sum. But it was in effect an exception or reservation of oil. The thing sold for the cash consideration was the lease and all the oil except that so reserved."

There is no possible distinction between that case and the instant case, nor is there any possible distinction between the instant case and the following cases, all of which make the same holding as the Fleming case:

Commissioner v. *Williams* (5th C. C. A.) (1936), 82 F. (2d) 328.

Commissioner v. *Elliott Petroleum Co.* (9th C. C. A.) (1936), 82 F. (2d) 193.

Holly Development Co. v. *Commissioner* (9th C. C. A.) (1937), 93 F. (2d) 146.

Spalding v. *United States* (9th C. C. A.) (1938), 97 F. (2d) 697 (Certiorari denied, 305 U. S. 571).

Dearing v. *Commissioner* (5th C. C. A (1939), 102 F. (2d) 91.

Ortiz Oil Corp. v. *Commissioner* (5th C. C. A.) (1939), 102 F. (2d) 508.

Perkins v. *Thomas* (5th C. C. A.) (1936), 86 F. (2d) 954.

In the latter case which was affirmed in *Thomas* v. *Perkins*, *supra*, the Court, speaking of the in-oil payment, said:

> "But the portion of the proceeds going to the transferors is not income to the transferees. It is not the proceeds of the transferees' oil paid over to the transferors in discharge of an obligation."

So in the instant case the proceeds of the oil payable to the Oklahoma Company was not income to Prichard. It was not the proceeds of his oil paid over to the Oklahoma Company in discharge of an obligation.

In *Holly Development Co.* v. *Commissioner*, *supra*, there was a contract by which:

> "Argonaut, in consideration of $10.00 and the covenants, granted, sold, assigned and transferred to Sinsheimer certain oil leases,"

and by which:

> "Argonaut agreed to immediately put Sinsheimer in possession of the premises whereupon he was to take charge of operations and it also agreed to execute and deliver the necessary instruments to convey title to the leases. * * * All of the proceeds from the production of the wells was to be received by Sinsheimer,"

who was to pay therefrom rentals and royalties and operating expenses and to Argonaut "$6,000 per month until it should have received $120,000." Sinsheimer's title and rights were assigned to the petitioner.

In construing this agreement the Court said that the in-oil payments were income to Argonaut and not to the petitioner "because by the agreement referred to, Argonaut excepted and reserved to itself an interest in the lease and in the oil."

Practically all the cases cited above herein are cited by the Court in support of that statement. There is no possible distinction in legal effect between the contract involved in that case and the conveyances pursuant thereto and the contract involved in this case and the conveyances pursuant thereto, except that in that case it does not appear that the contract provided that the transferor should have a lien on the property transferred or the oil production from it to secure the in-oil payments.

In the only cases dealing with a contract and assignment where a lien was reserved, so far as we know, it has been held that the reservation of the lien was for the purpose of securing the performance of the contract by the transferee, and did not prevent the transferor from retaining and holding an equitable or economic interest in the property transferred.

In *Ortiz Oil Company*, 37 B. T. A. 656, that company agreed with Westbrook and Thompson for a cash consideration to pay $350,000 out of oil to be produced from properties owned by it. The contract provided that in event the company violated the provisions of the contract, the whole sum might be declared:

> "Immediately due and payable, and they shall have automatically at that time a lien on said oil and gas leases and leasehold and all personal property thereon or used and obtained in connection therewith, and all wells and production, and all of the rights, title and interest of Ortiz Oil Company, in and to the same, which said lien may be foreclosed in Court the same as a Vendors Lien, Mortgage Lien, or any other lien" (Page 659).

Ortiz Oil Company contended that the transaction was a loan by Westbrook and Thompson, and not the purchase of an interest in the oil and gas leases and that all oil production therefrom was its income upon which it was entitled to a deduction for depletion, and urged that the giving of the lien negatived the claim that Westbrook and Thompson had an interest in the property.

In passing on this the Board said:

"Such portions of the production belonged to and constituted property of Westbrook and Thompson, and petitioner was obligated only to pay over and account to them therefor, when produced. The lien given to Westbrook and Thompson was not intended to secure the repayment of a loan, but to insure that petitioner would adhere to and perform the conditions of the contract and 'pay and account' to them for their share of the oil when produced.

"Petitioner was to develop and operate the properties, and pay all expenses. Westbrook and Thompson acquired an 'overriding interest,' their portions of the oil runs being net to them. Westbrook and Thompson paid the money in exchange for an agreed interest in any oil and gas or other minerals that might be 'produced, saved and sold' from petitioner's properties. If none were produced, they lost their money, and petitioner was under no obligation to repay it. (Page 664).

* * * * * * * * *

"The right to share in the oil produced constituted an interest in the oil in place. Hence, the right of Westbrook and Thompson to their proportion of the oil and gas, or proceeds from sales, upon production, constituted an economic interest in the properties, to the extent of the amount agreed upon. Likewise, the right of petitioner to the balance of production constituted an economic interest in the properties. Proceeds from sales of production, therefore, constituted income to Westbrook and Thompson to the extent of the proportion received by them, and the balance only constituted gross income to petitioner" (Page 665).

In support of its holding the Board cites the same court cases cited herein. The decision of the Board was affirmed

on review by the Fifth Circuit Court of Appeals in *Ortiz Oil Co.* v. *Commissioner*, *supra*. The Court makes substantially the same holding in substantially the same language as the Board and cites the same authorities.

In *Wilbert Mineral Corporation*, 38 B. T. A. 355, the facts were that the owners of land sold and conveyed it in fee simple absolute to a corporation under an agreement whereby the vendor was to receive $400,000 "from the first revenues earned or received either by way of lease, royalties or otherwise from the oil, gas and other mineral rights in and under the lands" conveyed. The vendee was a corporation and it executed a mortgage and pledged corporate stock to secure the payment of said sum. The Board, after an elaborate review of the authorities, held that the mortgage and pledge were merely security for the performance of the contract on the part of the vendee. In the opinion it is said:

> "We think that the mortgage and pledge should be regarded merely as precautionary measures to guarantee the carrying out of the intention of all the parties concerned, namely, that petitioner was not to enjoy any of the revenue from the mineral rights until the Lumber Co. had received the first $400,000 from that source. *Cf. Ortiz Oil Co.*, 37 B.T.A. 656. In other words, we think the controlling fact is that every precaution was taken to make sure that the first $400,000 of 'revenues earned or received, either by way of lease, royalties or otherwise from the oil, gas and other mineral rights in and under the said lands' would go to the Lumber Co., to be used in paying its debts and the debts of the Planting Co., which it took over in April,

1929. It was a reservation of income to the grantors out of the lands conveyed and was not purchase money. *Perkins* v. *Thomas*, *supra*" (Page 366).

And in *Alexander* v. *Continental Petroleum Company* (10th C. C. A.) (1933), 63 F. (2d) 927, the same court that decided this case below, but with a different personnel, held exactly contrary to its holding in the instant case with respect to the effect of an absolute transfer of title to oil and gas leases and the execution of a lien thereon to secure part of the cash purchase price, which transfer was made pursuant to a contract that the transferor should receive $2,471,241 out of one-half of the lessee's assigned interest in the oil produced. It was there contended by the Government's representative, Alexander, collector, that the transfer of the leases was an outright sale, that the in-oil payments were income to the assignee, and that the assignor was not entitled to the deduction of an allowance for depletion on such in-oil payments which it received. The Court said:

"There were provisions for securing the payments by liens, for the sale of the equipment used or held for use upon the leases, and for the delivery of abstracts of title. * * *

"When the notes were paid the liens were to be released, and on the payment in oil the reservation thereof was to be satisfied. * * *

"The defendant contends, in substance, that the transfer of the leases was absolute and as a result left no reserved interest in the vendor subject to depletion. We may agree that the transfer was a sale of the leases.

> But it was not an end of the plaintiff's interest in the production of the oil."

So here it may be agreed that the transaction was a sale of the properties from the Oklahoma Company to Prichard. But that was not an end of the Oklahoma Company's interest in the production of the oil, and if the execution of express liens on the leases assigned in the above case was not sufficiently significant there to defeat the vendor's claim of a reserved interest in the oil production, no reason appears why the mere recital in the contract that the Oklahoma Company claimed a lien on that part of the property out of which it was to receive $110,000 should defeat its claim, if it made such claim, that this sum was income from in-oil payments direct from the property upon which it was entitled to the deduction of a depletion allowance. If it was entitled to depletion allowance on those in-oil payments, then they could not have been income to Prichard at the same time. *Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S. 312; *Thomas* v. *Perkins*, 301 U. S. 655. In the latter case the Court said, in construing the assignment there under consideration, which was itself an absolute transfer of the leases:

> "We need not decide whether technical title to the oil while in the ground was in assignors, or in assignee."

Of the Circuit Court of Appeals cases cited above, the Holly Development Co., the Spalding, the Dearing, and the Ortiz Oil Corporation cases have been decided since *Thomas* v. *Perkins*. In all of these, as well as in all the others cited, *there was an absolute and complete transfer of the*

legal title to the oil properties involved and only a provision by contract that the transferor should receive a sum of money out of subsequent oil production therefrom and not otherwise, and in every case it is held that these in-oil payments were income direct from the property to the transferor, and hence were not income to the transferee owner and operator of the property.

It would serve no useful purpose here to give in any detail the precise facts of each case and analyze or quote the court's decision. This Court will, if it cares to, examine those cases, and if they fully support the petitioners' contention here, which their counsel say they do, this Court will so recognize them.

For emphasis we repeat that since *Palmer* v. *Bender*, 287 U. S. 551, no court has held that the ownership of the legal title or any interest in the legal title to an oil producing property, or the ownership of oil and gas in place in the ground, was necessary to require one who had a right to receive a sum of money from oil produced from such property and not otherwise, to return sums so received as his income direct from the property, and to entitle him to an al' wance for depletion on such income. This is recognized in *Thomas* v. *Perkins* and in all the cases cited herein both before and after that case.

In the instant case the only reason given by the Court below for not following *Thomas* v. *Perkins* was that here there was an absolute transfer of the legal title and a recital in the contract of sale that the seller would claim a

lien for the amounts to be received out of the property, and that the contract made provision for releasing this lien. *In every case cited herein there is the express statement or plain implication in the contract involved that a release or satisfaction of the right to share in the oil production would be executed when the stipulated amount due the transferor had been fully paid.* Indeed, this would follow as a matter of course without any provision concerning it. The lien specified in the instant case is no more than the vendor's lien given to the Oklahoma Company by statute upon the transfer of the property with part of the purchase price remaining unpaid. There can be no significance in the mentioning of this lien and the provisions for the release of Prichard's obligation to pay over and account when the specified sum had been paid in full.

In the Court below the respondent urged that the cases of *Helvering* v. *Bankline Oil Co.* (1938), 303 U. S. 362; *Helvering* v. *O'Donnell* (1938), 303 U. S. 370, and *Helvering* v. *Elbe Oil Land Development Company* (1938), 303 U. S. 372, were contrary to the petitioners' contention. But that Court made no reference to these cases and its decision is not in any way based on them. They are each clearly distinguishable on the facts from the instant case, and there is no need for petitioners to point out the grounds of distinction. It is sufficient to say that none of them present a state of facts wherein a taxpayer owning and having capital investment in oil producing properties has transferred them to another with the stipulated provision in the contract for their sale and transfer that the transferor

should receive a specified sum out of a portion of the gross proceeds from oil production from them. Under those decisions the transferor in a transaction such as that stated, has a retained capital investment in the properties transferred in the form of an equitable or economic interest in the oil and gas deposit in them.

In the Bankline case the taxpayer was a mere contract purchaser of casinghead gas and did not have and had never had any capital investment in the properties producing the gas. In the O'Donnell case the taxpayer merely owned stock in a corporation which owned oil properties and upon the sale of the stock received as part consideration an agreement for a share in the net profits from the operation of the properties which was merely a personal covenant of his transferee. He did not have and had never had any capital investment in the oil properties. In the Elbe Oil case the taxpayer made an outright sale of oil and gas properties for a cash consideration, payable in installments, and a further provision that after the transferee had been reimbursed for all of its expense in the acquisition, development and operation of the properties, then the transferor should receive one-third of the net profits resulting from production and operation. The taxpayer claimed that the cash payments on the purchase price were bonuses or advance royalties and that it was entitled to a deduction of a depletion allowance on such payments in excess of its cost in the properties. The Court said that these cash payments were the purchase price on an outright sale of the property. The question of the character of the trans-

feror's share in the ultimate net profits from the properties, if there ever should be any, was not before the court. In none of these cases is *Thomas* v. *Perkins* modified, criticized or qualified in any respect, but wherever referred to, it is cited or quoted with approval.

We may add that the petitioners' controversy with the Government in this case is not whether the payment to the Oklahoma Company out of oil production from the property is or is not taxable income, but it is whether those payments are taxable income to petitioners or to the Oklahoma Company. That company owned and had a capital investment in the properties before the transfer of them and by its contract of sale retained an interest and capital investment in them. In so far as the in-oil payments here involved are concerned, they were a realization upon its retained capital investment in those properties.

This Court ought to grant the writs of certiorari in this case and reconcile the conflict between the decisions of the various Circuit Courts of Appeals cited under this proposition and the decision of the court below in the instant case. This even if all that is needful is to point out that this case comes within and is controlled by *Thomas* v. *Perkins*, otherwise sooner or later those Circuit Courts of Appeals will reaffirm their previous decisions and refuse to follow the Tenth Circuit in the instant case, and the precise question here presented will again come before this Court for determination.

Both the Board and the court below cite with approval *Comar Oil Co.* v. *Burnet* (8th C. C. A.), 64 Fed. (2d) 965, which this Court expressly held in conflict with *Thomas* v. *Perkins, supra.*

So we conclude on this proposition that under all pertinent decisions from *Palmer* v. *Bender* down to the instant case, one who has a capital investment in and owns an oil property by title in fee simple absolute and sells it to another, and transfers it to the purchaser by the same kind of title; and by the contract of sale reserves a right or stipulates that he shall have the right, to receive a sum of money out of the gross proceeds of oil to be produced, if, as and when produced, and not otherwise, has such an economic interest in that property as to make such in-oil payments when received, income direct to him from the property and not income to or through the transferee and owner and operator of the property, and he is required to include such in-oil payments in his gross income for tax purposes and is entitled to the deduction therefrom of allowances for depletion. If this is a correct statement of the law, then the in-oil payments here in controversy could not be income to the petitioners.

Second Proposition

Under the terms of the Contract between the Oklahoma Company and Prichard he took the legal title to the properties involved by transfer and conveyance from the company as its trustee or agent or attorney in fact and repository of title for the purpose of operating and/or selling such properties and paying over to it one-half of the gross proceeds so realized therefrom up to $110,000 and hence all sums so paid to it were income direct to it from the properties and were never income to Prichard.

Petitioners contend that the foregoing states a proposition of general law and that the decision of the court below to the contrary is untenable and in conflict with the weight of authority. The principle of general law that one who serves as a mere instrumentality or agency for collecting, receiving and paying over money to another to whom it belongs, has no ownership in such money, nor any legal title or interest in it other than as a custodian, and if there is gain and profit to some one in the money which he thus collects and pays over such gain and profit is that of his principal, is so fundamental that no authorities need be presented to support it.

The petitioners' further contention under this proposition is that the decision of the court below is in direct conflict with the decisions of other Circuit Courts of Appeals where the same question is involved on similar states of fact. These decisions support the provision of general law above stated and apply it to specific states of fact such as those here involved. The number of cases so holding is

not exhausted by those here presented but the ones presented are sufficient to establish the petitioners' contention.

In *Shellabarger* v. *Commissioner* (7th C. C. A.) (1930), 38 Fed. (2d) 566, a father died testate and bequeathed the bulk of his estate to his daughter, Maud, and a nominal amount to his daughter, Georgia. To settle a threatened contest Maud agreed to give Georgia half of a $20,000 legacy and to pay to her as received for the period of her life 3/10 of the net income from two trusts created by the will and an additional 1/5 to a bank as trustee for the use of Georgia's descendants.

The Commissioner held that this 3/10 and 1/5 of the income from the trust was Maud's income and subject to tax in her hands. The Board of Tax Appeals sustained the Commissioner and the Circuit Court of Appeals reversed the Board.

The Court said:

> "So in the case before us it is quite immaterial whether there was employed language purporting to convey a half interest in the net income, or agreeing to pay over the half as it was received—the result is the same.
>
> "As the fund was paid over to Maud, the interest of Georgia and the bank immediately attached, and Maud became in equity a trustee for the benefit of Georgia and the bank. * * * The valid agreement to pay as received half of the income of the trusts conferred an equitable lien on the fund when it came into existence. *Ingersoll* v. *Coram*, 211 U. S. 335, 29 S. Ct. 92, 53 L. Ed. 208.

"While the whole of the net income from the trusts was physically received by Maud, the half did not accrue to her as her income, but on the instant of receiving it she held it in trust for Georgia and the bank, and it was in good faith paid over as received, pursuant to her valid and binding contract."

So here while the whole of the gross proceeds or revenues from the properties was physically received by Prichard, the half thereof was not his income, but on the instant of receiving it, he held it in trust for the Oklahoma Company and it was in good faith paid over as received pursuant to the valid and binding contract. If the decision of the Seventh Circuit Court of Appeals in the above case is right, then the decision of the Tenth Circuit Court of Appeals in this case is wrong.

In *Bettendorf* v. *Commissioner of Internal Revenue* (8th C. C. A) (1931), 49 Fed. (2d) 173, the facts were that Catherine Bettendorf transferred certain corporate stock to her son, Joseph, by a written contract which provided that he should pay to her as long as she lived all earnings and dividends paid on any or all of the stock except a stock dividend, which, if declared, would be his property.

The Commissioner ruled that earnings on this stock were income to Joseph and subject to tax in his hands before being paid over to Catherine. The Board of Tax Appeals upheld the Commissioner. The Circuit Court of Appeals reversed the Board.

In its opinion the Court said:

"By her contract, however, she transferred the legal

title to the stock, but by the terms of this same contract she retained and reserved to herself the right to the income during her life. The income was therefore at no time that of the petitioner, because by the very contract under which he held the legal title he was bound to account to the donor for the income. The contract required that the petitioner account only for such income as accrued, and not for a specified sum. He was not chargeable personally with the income from the stock, except as and when it should be received by him.

* * * * * *

"We must assume that it was not the purpose of the [revenue] act to penalize an individual because he might be the innocent agency by or through whom a substantial income was derived for some one else. The government will not restore to sharp practice, nor invoke technical construction or fiction, which will manifestly thwart the good-faith intention of its taxpayers, for the purpose of visiting a tax burden upon one who in fact did not, except by construction, derive any beneficial income from the transaction. The income which petitioner received from these securities was not the income with which one pays debts. By this contract, Catherine Bettendorf made a gift of the securities, receiving nothing in exchange, but she retained, for the period of her own life, the right to the income. The petitioner, by the terms of the contract, assented to this reservation, and he thereby became a trustee, and was required to account to his mother for the earnings received."

There is no distinction upon the facts or in the rule of law applicable between that case and this one.

In *Central Life Assur. Soc. Mut.* v. *Commissioner of Internal Revenue* (8th C. C. A.) (1931), 51 Fed. (2d) 939, the Central Life Assurance Society of the United States sold and assigned its insurance business to the Central Life Assurance Society Mutual with a provision in the contract that the purchasing company should pay to the stockholders of the selling company the earnings from the nonparticipating business sold and transferred for a period of 22 years.

The Commissioner held that the earnings from the nonparticipating business were income to the purchasing company and subject to tax in its hands before being paid over to the stockholders of the selling company under the contract The Board of Tax Appeals upheld the Commissioner. The Circuit Court of Appeals reversed the Board.

In the opinion the Court said:

> "The issue here is whether those earnings constituted income of the petitioner, in a taxable sense, or were income of the stockholders. The contention of the petitioner is that it was a trustee of such earnings for the benefit of the stockholders.
>
> "Tax laws are essentially practical in their purposes and application, and the federal income tax laws are no exception. While, for purposes of convenience and certainty in collection of such taxes, it is sometimes provided that those who collect income for others shall pay therefrom the taxes thereon, yet a cardinal purpose of the income tax laws is to tax the income to the person who has the right or beneficial interest therein, and not to throw the burden upon a mere collector or conduit through whom or which the income passes. (Citing cases.) * * * It is unnecessary to de-

termine whether the relationship here is technically a fullclothed trust or is something else, although the facts here may well be held to establish a trust relation as to this income.***The undisputed fact is that the petitioner bound itself to pay to designated persons any earnings there may be for a period of twenty-two years from the date hereof, from the nonparticipating business hereby and hereunder transferred. * * * These earnings never became the absolute property of petitioner, and it could lawfully do with them but one thing, which was to pay them over in accordance with the contract. It secured no beneficial interest whatsoever from them. There was as complete a segregation of these earnings as could possibly be made under the circumstances."

The petitioner's contention in the above case is precisely the contention of the petitioners here. There is no essential distinction on the facts between that case and this one and if the Eighth Circuit Court of Appeals was right in that case, the Tenth Circuit Court of Appeals is wrong in this one.

In *Helvering* v. *Falk* (1934), 291 U. S. 183, this Court had before it certain trusts in mining properties, part of the income from which was required to be distributed to beneficiaries, and the question was whether they had the right to depletion allowances on the amounts so distributed. Of the trust deed the Court said:

"After providing for payment of taxes, expenses, etc., the deed directed: 'Except as above authorized to be expended, paid out or retained, all proceeds which shall come to the hands of the Trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by

the Trustees shall belong to and be the property of the beneficiaries hereunder to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein, or as the same shall from time to time appear as hereinafter provided."

Then after an extended discussion the Court reached the conclusion that the distributions to the beneficiaries were income to them direct from the mining properties through the intervention of the trustees and that they were entitled to appropriate depletion allowances. The Court said:

"Here the governing instruments directed payment to the beneficiaries of the entire proceeds, less expenditures, etc., and the trustees must be regarded as a mere conduit for passing them to the beneficial owners. Part only of the proceeds was subjected to taxation. The other part was left untaxed and remained so in the hands of the beneficiaries."

It is believed that the holding in this case is pertinent here, for that Prichard must be regarded as a mere conduit for passing one-half of the gross proceeds of whatever sort realized from the properties to the beneficial owner thereof, the Oklahoma Company.

A number of Board of Tax Appeals decisions could be cited in support of petitioners' contention here, but two are sufficient for the purpose. See:

Stephen J. Hallahan, 14 B. T. A. 584, 596, 597.

Mark D Eagleton, 35 B. T. A. 551, 562.

If the authorities cited are not convincing of the soundness of the proposition under consideration, more of the same kind would not be.

It seems too plain for dispute that no part of the proceeds coming to Prichard from the properties and by him paid under his contract obligation to the Oklahoma Company was in any sense his income or his money. This was not the kind of income with which one pays debts. He could not divert it to any use or purpose other than payment over to the Oklahoma Company. If he had done so, he would have been guilty of conversion of funds belonging to that company and possibly of embezzlement. It is not conceivable that he was or could have been anything more than a trustee of the legal title to the properties for the benefit of the Oklahoma Company for the realization out of one-half the gross proceeds derived from them of the $110,000 expressly reserved to it by the contract. It is fundamentally unjust that he should be required to pay income tax on this money. The property he acquired was that described in the contract less an interest of $110,000 in value carved out of it and retained by the Oklahoma Company.

It was urged by respondent in the court below that Prichard was using the sums paid to the Oklahoma Company to acquire valuable properties and a large capital investment for himself. The obvious error in this is that he never acquired any right to or interest in the $110,000 in question and presumably paid full value, by the down payment in cash of $50,000 and the expense of operating the property, for the estate or interest he acquired therein which was the

full title subject to or charged with the payment of $110,000. It might very well have been that the property would prove to be not worth what he was paying for it, charged as it was with the burden of $110,000 out of one-half of the gross proceeds from it. There was a speculative element in his contract, and if it turned out to be profitable, he was certainly entitled to the benefit of his bargain. The record does not show, and it is not material here that it should show, the amount of taxes and special assessments against the real estate transferred, nor whether these were less than, equalled or exceeded its value. It is specifically provided in the contract that he took the properties charged with that tax liability (R. 23).

The question here is simply illustrated: A owns an interest-bearing promissory note for $1,000. He sells, endorses without recourse, and delivers it to B for $250 cash and B's agreement to try to collect it and, if, as and when he collects, to pay to A half of all sums collected until A has so received $500. B collects $800 of which he pays A $400. Query: Is this $400 gain, profit and taxable income to B? Substitute the Oklahoma Company for A, and properties for the note and Prichard for B, and we have the present case.

It is sufficient to say that none of the $110,000 reserved and payable to the Oklahoma Company out of one-half the gross proceeds realized from the the property was or could have been Prichard's money or income. Under the authorities presented under the preceding proposition the Oklahoma company was entitled to a depletion allow-

ance on the in-oil payment. This itself is decisive of the question whether those in-oil payments were income to Prichard, for if the Oklahoma Company was entitled to a depletion allowance on them, he could not be.

CONCLUSION

The petitioners say in conclusion that the decision of the Appeals Court is in direct conflict with the decisions of other Circuit Courts of Appeals and apparently in conflict with the decisions of this Court which have been cited herein under their first proposition, and is likewise in conflict with the principles of general law stated in their second proposition and with the decisions of the Circuit Courts of Appeals and of this Court there cited. They contend that not only is the decision of the Appeals Court in conflict with those decisions, but it is fundamentally wrong and has the effect to impose a tax on petitioners on alleged income which was never really theirs. They repeat that if their contention is sustained, it does not mean that the income in dispute will escape taxation, but means only that it will be taxed to the one whose income it actually and really is and not be taxed to one who had no right or title to it but served merely as a collector and channel or conduit for receiving it and passing it on to its actual owner.

They ask that this Court grant the writs of certiorari as prayed for and review the decision of the court below.

Respectfully submitted,

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